Mark Pieth

Collective Action and Corruption
Basel Institute on Governance

International Centre for Collective Action

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Mark Pieth has served as Professor of Criminal Law and Criminology at the University of Basel, Switzerland since 1993. Having completed his undergraduate degree and his PhD in criminal law and criminal procedure at this university, he spent an extensive period of time abroad, most notably at the Max Planck Institute for Criminal Law and Criminology in Germany and the Cambridge Institute of Criminology in the United Kingdom. After practicing for a time as a private barrister ('Advokat'), he returned to his alma mater to complete his post-doctoral ('habilitation') thesis on sanctioning and other aspects of criminology. From 1989 to 1993, Mark Pieth was Head of Section - Economic and Organised Crime at the Swiss Federal Office of Justice (Ministry of Justice and Police). In this role, he drafted legislation against money laundering, organized crime, drug abuse, corruption and the confiscation of assets. As a government official and later as an independent consultant, he also acquired extensive experience in international fora, amongst other things, serving as Member of the Financial Action Task Force on Money Laundering (FATF), Member of the Chemical Action Task Force on Precursor Chemicals and Chair of an intergovernmental expert group charged by the United Nations with determining the extent of the illicit traffic in drugs. From the mid-1990s to the present, Mark Pieth has held a range of functions at the international level. He has chaired the OECD Working Group on Bribery in International Business Transactions since 1990. In spring 2004, he was appointed by the UN Secretary General to the Independent Inquiry Committee into the Iraq Oil-for-Food Program. In autumn 2008, Mark Pieth joined the Integrity Advisory Board of The World Bank Group (IAB), advising the President of Bank and the Audit Committee on integrity issues.
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Introduction

The term Collective Action has long been used in economics and the social sciences to address the difficulties associated with jointly accessing public goods: citizens are sometimes expected to refrain from individually profitable actions for the sake of the common good. And yet individual self-interest usually prevails. With The Logic of Collective Action, Mancur Olson founded the theory of Collective Action, though some of the underlying ideas are much older. Economists have employed game analysis to explore aspects of the prisoner’s dilemma. From this perspective, corruption is a typical Collective Action problem. Kingston puts it rather bluntly when he says: "The citizens or firms dealing with a corrupt government official would all benefit from an agreement not to pay bribes, but each has an incentive to pay bribes to try to get preferential treatment". His fellow academics have put forward several models to overcome Collective Action impediments, including in the area of corruption. They attempt, amongst other things, to neutralize the free-rider problem.

In the area of combating corruption, the topic of Collective Action has transitioned from being a major academic think-piece into a very concrete policy issue: Collective Action is now a kind of catch-all term for industry standards, multi-stakeholder initiatives, and public-private partnerships (PPPs). It may take on the form of an anti-corruption declaration, an Integrity Pact (or an "Island of Integrity") or, even, a certifying effort. The World Bank Institute (WBI), in its Fighting Corruption Through Collective Action, A Guide for Business, defines – and justifies – "Collective Action" as a collaborative and sustained process of cooperation amongst stakeholders. It increases the impact and credibility of individual action, brings vulnerable individual players into an alliance of like-minded organizations and levels the playing field between competitors. Collective Action can complement or temporarily substitute for and strengthen weak local laws and anti-corruption practices.

Its main significance is as a way out of serious dilemmas in international business. Over the last two decades, states and international organizations have promulgated regulatory standards in the areas of environmental protection, labor relations, and safety, as well as

3 Holzinger 2003, 2.
4 Olson 1965.
5 Hardin 2012, 3 et seq.
6 Holzinger 2003, 4 et seq.
7 Hardin 2012; Reuben 2003, 26 et seq.; Sandler 2010, 40 et seq.
8 Brütsch/Lehmkuhl 2007, 12; Kingston 2004; Mostipan 2009.
12 Hardin 2012.
13 Pieth 2007, 81 et seq.
14 This was the goal of early Collective Action initiatives in the power systems and the defense industries between 2000 and 2003.
15 Wiehen 1999a; 1999b.
16 WBI 2008, Slide 33.
17 WBI 2008, Slide 34.
on the “macro crimes” of illegal trusts, money laundering, embargo breaches, and corruption. Since the turn of this century, they have dramatically stepped up law enforcement on international commercial corruption in particular. Multinational enterprises (MNEs) and small and medium-sized enterprises (SMEs) alike face considerable risks when caught bribing foreign public officials. And yet, they find themselves in a tight spot in many areas of the world where corruption remains endemic and they are regularly confronted with extortionate demands. On the one hand, if they give in to solicitation they may face legal action in the “victim country” or their country of domicile. Since solicitation is not a valid excuse\(^\text{19}\), a defense of extortion will only be heard in extreme cases of physical threat\(^\text{20}\). On the other hand, if they take the ethical high road they could easily lose business. Now, commercially strong players may be well-connected in the “victim country” – even in places with particularly bad reputations – and they may be able to resist the challenge by escalating the issue appropriately. Typically, however, even large companies are uneasy about “going it alone”. They are uncertain whether their competitors are following the same virtuous path and they are aware they may be sidelined by ministers “on the take” and replaced by less scrupulous suppliers. This is what Collective Action theorists meant by *defection*\(^\text{21}\). In such circumstances, Collective Action – be it a common standard amongst competitors, a joint demarche to government, or a bidders’ anti-corruption pledge – could be used to escape the dilemma collectively.

### The historical background

**De-regulation and re-regulation**

Ironically, new international forms of regulation were themselves responses to new forms of de-regulation. With increasing economic, political, and social globalization during the 1970s and 1980s, national governments and international organizations (including the Bretton Woods institutions) promoted the goals of market liberalization and privatization\(^\text{22}\). It rapidly became apparent, however, that nation states, especially in the South, were unable to protect themselves against abuses by MNEs, which were typically domiciled the North. Environmental catastrophes, child labor, and corruption were commonplace\(^\text{23}\). Increasing criticism by civil society groups prompted international organizations to opt for *re-regulation* of a different kind: international behavioral standards (such as the Organisation for Economic Co-operation and Development’s *OECD Guidelines for Multinationals*\(^\text{24}\)), coupled with industry self-regulation. Self-regulation was considered cheaper, more flexible, and less burdensome than public regulation\(^\text{25}\). However, it too soon emerged as insufficient to deal with the formidable international challenges. Amongst other things, transnational economic and organized

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\(^{20}\) Murphy 2011, 136; Pieth 2011, 70.

\(^{21}\) Mostipan 2009, 6 (referring to Olson 1965).

\(^{22}\) Jenkins 2001, 1 et seq.

\(^{23}\) Hauffer 2001, 11; Jenkins 2001, 2 et seq.


criminals were making use of the newly guaranteed free movement of people, goods, and capital.

Co-regulation

Supplanting traditional command and control-style regulation26 was “co-regulation”27. A hybrid system of regulation28, it is made up of international “hard” and “soft” law standards that are set, implemented, and monitored by state and non-state actors29 (private sector and civil society organizations). It quickly became the regulatory model of choice for nation states. Researchers talk of the law of co-operation replacing the law of co-existence amongst states in a world of increased international legalization30. Monitoring by peers and third parties is now a regular element of regulation both between states and amongst companies.

Regulating corruption

As for corruption, a new phase of regulation followed the end of the Cold War and the opening of new markets in the former second and third worlds. In view of the upcoming redistribution of markets, major economic players (states and corporations) were not content to allow access to be influenced by unfair trade practices, such as corruption. Increasingly, states used task forces to focus on specific topics and to circumvent cumbersome negotiation procedures31. Alongside traditional conventions and dispute settlement procedures, new international instruments began to appear. The radical change was first apparent in regulations on the financial sector particularly, the soft law standards and peer pressure enforcement mechanisms of the Financial Action Task Force (FATF). What started as an effort to reduce money laundering32, was rapidly extended to the financing of terrorism33, corruption-related money laundering34, and, eventually, financial flows from tax fraud35. When tackling corruption after 198936, the OECD broadly copied the FATF methodology. The OECD Working Group on Bribery (OECD-WGB) opted to develop an actual convention on criminalization, the OECD Anti-Bribery Convention (OECD-ABC)37 and a recommendation for related matters in 199738. Both the FATF and the OECD-WGB used peer review aggressively39. Regional organizations in Europe40 and the Americas41 soon followed suit, as did the UN, ultimately, with its 2003

26 Black 2002, 2 et seq.
27 Black 2001, 6 et seq.; Hauffler 2001, 12; Pieth 2007a, 94.
28 Brütsch/Lehmkuhl 2007, 23.
29 Peters/Koechlin/Förster/Fenner Zinkernagel 2009.
30 Brütsch/Lehmkuhl 2007, 13.
31 Pieth 2007a, 94 et seq.
34 From the second, 1996 edition of the FATF 40 Recommendations.
36 Pieth 2007b, 11 et seq.
39 Bonucci 2007, 445 et seq.
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Ensuring enforcement

The various monitoring mechanisms have adopted a variety of styles, the OECD-WGB probably being the most outspoken and undiplomatic. Since its goals are most directly linked to the competition agenda, it assesses how countries deal with specific cases, as well as their laws and levels of awareness. Even though the OECD-WGB is not an international court, it can require states, through the responsible law enforcement agencies, to tell their peers why they have not opened or why they have closed a particular case. If there is no reasonable explanation for the state’s decision to close an individual case (such as a lack of evidence, lapse of time, or lack of jurisdiction), and a cluster of such allegations are not followed up, the effectiveness of the country’s system will be put into question.

A country may even be put on probation and forced to explain at regular intervals (e.g., every six months) how its cases are advancing. As a last resort, the group can ask a country to reopen a specific case that has been closed and threaten trade sanctions in the event of non-compliance.

With increased pressure for implementation on states, has come a dramatic increase in the risk to companies of enforcement. It should be no surprise that the private sector is itself becoming more active in combating corruption. First, it is very much interested in extending the anti-corruption standards to other exporting nations, especially Brazil, Russia, India, and China (the BRIC countries). Here, the G20 format is proving very handy. Second, the private sector has become even more insistent than the peer countries that anti-corruption standards are applied equally. Third, companies have acknowledged that they are dependent on the evolution of a reliable body of common standards.

Corporate motives?

Companies have complex motivations for entering into particular Collective Action initiatives. Industry representatives usually emphasize the need to create “a level playing field for commerce” and “prevent regulatory arbitrage”. However, collective risk management is always, at least in part, expectation management: with similar levels of regulation amongst all competitors, companies are also better able to limit costs. Also, members of the “club of the virtuous” may hope to be rewarded for their efforts with preferential treatment, e.g., in public procurement processes (by definition, they pose a lower risk to potential “victim states”). In all, there could be a strong business case for collectively combating corruption. Once again, this is a clear reference back to the theory of Collective Action, where ways are sought to exclude free riders from benefits.

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43 See, e.g., OECD 2012.
45 See, e.g., OECD 2008.
48 Mostipan 2009, 6; Sandler 2010, 44.
49 Reuben 2003, 7.
Early experiments

The history of early experiments with Collective Action in relation to corruption and money laundering is far from straightforward: it is a story of early success and failure, and renewed efforts.

Early success: Wolfsberg

During the 1990s, regulation of the financial industries dramatically increased, anti-money laundering standards abounding in particular. For banks, it seemed that regulators had gone out of control. It was as if they were continuously raising the bar for compliance without really understanding the challenges for business. And, though complaints about singling out by regulators were rife, competitors had not yet considered the possibility of sitting down together and drafting an anti-money laundering compact of their own. Indeed, when civil society organizations and far-sighted bankers first raised the idea, most executives responded semi-automatically with concerns about breaching laws on anti-competitive trusts. Perhaps this was a self-protective reflex, aimed at preventing their institutions from rushing prematurely into an ill-considered adventure. The common efforts were, nonetheless, the starting point for an initiative that served as a pattern for Collective Action initiatives to come: the Wolfsberg Banking Group.

Initially, Wolfsberg’s standards were relatively simple. They did not really go beyond what regulators had already decided. However, the activation of the private sector was a sensation in itself, drawing close to 200 journalists to a press conference. The fact that banks – so frequently criticized for laundering drug money and hiding dictator’s loot – would go on the offensive, was apparently spectacular in 2000.

The group met intensively and produced further compacts. It rapidly established itself as a crucial industry reference group for regulators and international public bodies, not unlike the FATF. Now, beyond its internal meetings, the Wolfsberg Group even holds an annual “Wolfsberg Forum”, inviting all relevant regulators and competitors to participate and comment on its annual catalogue of working documents. Thus, with time, the Wolfsberg Group matured into a strong self-regulatory body of the financial sector, one capable of dealing with issues of money laundering, the financing of terrorism, corruption, and embargo-busting.

Failed first attempts at anti-corruption Collective Action

Shortly after the Wolfsberg success, similar groups formed around the issue of corruption. One needs to keep in mind that the US law on foreign bribery, the Foreign Corrupt Practices Act (FCPA), had been in force since 1977, but that it had taken until 1997 for states to agree to enlarge its scope through the instruments of the OECD. State parties

50 The Basel Institute on Governance and TI.
52 The original principles were made public in a well-attended press conference in Zurich on October 30, 2000.
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to the OECD-ABC\textsuperscript{55} and the related recommendation\textsuperscript{56} were just about to enact laws on foreign bribery when these groups formed. The common denominator with the Wolfsberg Group was, then, the threat of intense cross-border public regulation; this motivated key players in certain industries to jointly formulate detailed standards.

Between 2000 and 2003, companies in the defense and the power systems sectors made early and impressive attempts to harmonize their compliance systems. In both sectors, groups labored for two to three years. However, distrust remained strong and public enforcement weak. In contrast to the financial sector, where regulators were already hitting non-compliant companies with heavy penalties, companies in these other industries were initially able to play a double game: they had incentive enough to say the right things and have convincing compliance systems on paper; but they also maintained impressive slush funds, just in case the anti-corruption initiatives did not really take off and they needed to bribe their way into contracts again. So, a European version\textsuperscript{57} of the successful US defense integrity initiative\textsuperscript{58} was derailed by the BAE scandal\textsuperscript{59}; only several years later, was a new – and genuinely transnational – text adopted\textsuperscript{60}. Similarly, a power systems initiative stalled shortly before signature, General Electric voicing particular concerns about the depth of commitment on the part of its colleagues\textsuperscript{61}.

Public-private partnerships: the Extractive Industries Transparency Initiative (EITI)

In the meantime, it had also rapidly become obvious that combating corruption from the supply side alone might not work since it hit at soft targets (companies and their employees), but it missed the recipients who (the demand side of corruption) and the financial intermediaries. In particular, oil producing states and their officials were identified as major contributors to the corruption cycle. The idea that oil companies (and mining corporations) would publicly declare what they had paid into the budgets of the producing state ("publish what you pay") was a major contribution to public accountability in these states. The EITI was then one of the first major PPPs in combating corruption. Governments of the North and the South, as well as corporations active in the entire sector, were linked up with the help of mediators from civil society\textsuperscript{62}.

A generic intermezzo

After the failure of the first initiatives in defense and heavy industry, new initiatives maintained the need for common standards as the fundamental point of departure. Rather than develop new codes, however, they went back to the generic, older texts, especially the ICC Rules of Conduct\textsuperscript{63} and the TI Business Principles\textsuperscript{64}.

The generic industry standards for companies were gradually overtaken by a new generation of public regulations: national standards on corporate liability. These began to integrate the notion of a “sound compliance program”, as defined by the US Sentencing

\begin{itemize}
  \item \textsuperscript{55} N. 37.
  \item \textsuperscript{56} N. 38.
  \item \textsuperscript{57} The Clovis Principles for the Defence Industry, Paris 2003.
  \item \textsuperscript{59} Pieth 2011, 19 with further references.
  \item \textsuperscript{60} See International Forum on Business Ethical Conduct for the Aerospace and Defense Industry, available at http://ifbec.info.
  \item \textsuperscript{61} The trust generated through this original process was lost when misconduct by major competitors became obvious.
  \item \textsuperscript{62} Brew/Moberg 2006, 128 et seq.
\end{itemize}
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Methods and challenges

Initiating Collective Action

In thinking about the possibilities for future Collective Action, one needs to consider why companies do not end up cooperating on their own. The answer is relatively simple: competitors usually trust each other little and they usually fear being perceived as “trusting” each other too much. In other words, many companies are wary of anti-corruption compacts lest they be regarded as engaging in anti-competitive behavior.

Now, their fears are baseless if the goal is genuinely to reduce the risk of bribery. The contrary is true, since Collective Action allows companies to focus on price and quality once more. But, trade associations, the traditional mediators, have generally failed to take on the role of bringing companies together. In my experience, they may be too slow and too risk averse. They typically represent a broader range of companies, beyond those interested in demanding a common solution to bribery and extortion. Repeatedly, therefore, Collective Action has been promoted first by an ad hoc group of representatives from one or more non-governmental organizations (NGOs), together with select private sector protagonists.

These consortia perform a crucial task in the early days of a Collective Action initiative by bringing together a group of industry representatives that is able to generate its own momentum.

The first moves are extremely sensitive. Though there is no set model for success, the civil society representatives frequently need to obtain the support of at least one industry champion. Together, they attempt to convince other major players to participate. At the outset, the participants avoid committing to anything beyond a preliminary exchange of views. It takes time to convince the participants of the benefits of the initiative, and much depends on the subtlety of the mediators. Once the initiative has taken off, however, the collaboration is publicized and corporate exponents take their share of the

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66 O’Shea 2011, 371 et seq.
68 In particular, the US Chamber of Commerce 2011. See further Henning 2012.
69 OECD 2010, p. 23 et seq.
70 Kingston 2004, 12 et seq.; Mostipan 2009, 10 et seq.
71 Frequently such business associations are shy of initiating a process, even if they may want to take it over once it is running (see, e.g., the defense industries).
72 See, e.g., Wolfisberg, PACI, and the aeronautics industries.
73 Siemens, TNT, or UBS in their respective contexts, to name just a few.
74 Brew/Moberg 2006, 132.
responsibility. In the meantime, it is also the task of the NGO representatives to ensure that the members of the group do not embark on anti-competitive behavior.

Thus, in starting a particular Collective Action initiative, the key factor is not (simply) the size of the group, as frequently suggested in academic debates about the conditions for overcoming Collective Action problems. It is assumed that a few, especially strong, players achieve more than a multitude of small actors—the larger the number, the greater the risk of truancy. Really, the challenges to Collective Action are concrete and tangible.

Contents

The substantive contents of the initiatives have evolved with the methodology of Collective Action. Originally, the fine-tuning of public standards that aimed at leveling commercial playing fields was at the forefront. Later, Collective Action initiatives became more refined, being expanded to involve the public sector, in public procurement pledges and so-called “Integrity Pacts”, amongst other things. These were intended to ensure that sound competitive practices became more relevant. More recently still, competitors have begun finding new creative uses for Collective Action, mutually opening their whistle-blower hotlines to each other, for example. Finally, several initiatives are directed at certifying business behavior.

Major challenges

There are still major challenges to Collective Action, however. Its informality is a particular impediment. Most initiatives have their basis in soft law and are only concluded among private operators, public players getting involved only occasionally. So, Collective Action initiatives typically suffer from the same deficiencies as self-regulation initiatives: it is unclear who is supposed to ensure that commitments are implemented.

Recent examples

Categorizing Collective Action

Over the last decade an entire spectrum of local, regional, and global Collective Action initiatives on corruption has emerged. They have been divided by the WBI into four categories:

- anti-corruption declarations
- principle-based initiatives
- Integrity Pacts
- certifying business coalitions

Pioneered by NGO, Transparency International (TI), sometime back, these very concrete forms of Collective Action are usually tied to specific contracts and monitored by

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75 Pieth/Aiolfi 2003, 267 et seq.
77 Sandler 2010, 40 et seq.
78 Such as the early efforts in the power systems sector, or the TI’s Business Principles, n. 64, or the PACI Principles.
79 See, e.g., the EITI, discussed further, Brew/Morberg 2006, n. 62.
80 Wiehen 1999a; 1999b.
81 E.g., The Makati Business Club’s activities in the Philippines under the Siemens Integrity Initiative, Siemens Integrity Initiative Slide Presentation, First Funding Round, February 2012, Slide 20.
civil society organizations.

**Back to sector-wide initiatives**

The time is also ripe for a fresh look at sector-wide Collective Action initiatives against corruption. Regulation has intensified to a point that non-compliance and law enforcement are perceived as real legal and reputational risks to corporations. They are now especially interested in reducing risks and leveling playing fields in emerging markets, such as Russia, Nigeria, Angola, China, and the Middle East.

Industry-specific groups are concentrating on particular topics: “facilitation payments” at customs in the logistics and transport industry; “offsets” in the defense industry and, to give another example, “signature bonuses” in the oil and gas industry.

Industry-specific groups are developing an overall interest in cross-cutting issues, like the obligation to hire intermediaries, a so-called “sponsor” (particularly in the Middle-East), or the problem of the solicitation of bribes.

**Activating creativity**

The future for Collective Action lies in addressing very real challenges with creative means, including the use of information technology. Some such initiatives have emerged; two examples are mentioned here:

**Logistics and transport**

Recently, major express carriers agreed to cooperate with the World Customs Organisation (WCO) and the People’s Republic of Vietnam in the introduction of an electronic customs procedure. The collaboration was facilitated by the World Economic Forum (PACI) and the Basel Institute on Governance, two civil society organizations. The new customs procedure, which is endorsed by the logistics and transportation industry, is more efficient than the existing manual process and far less vulnerable to misuse for rent-seeking. Therefore, it is an indirect means of reducing corruption, in the form of facilitation payments at customs. On the basis of the experiences gathered during the pilot study, it is thought that the procedure may be used in other emerging markets.

**High-Level Reporting Mechanisms (HLRM)**

The idea of “HLRMs” was born originally of discussions between general counsels of the largest heavy industries (power systems) groups, which was mediated by the Basel Institute on Governance. Frequently, even large companies find themselves confronted with outright extortion and, in some of the most difficult markets, are uneasy with escalating the matter individually. Hence, participants suggested the creation of ombudsman offices close to heads of government or heads of state. The organization of the structure would obviously be a matter for each country. The central idea, though, is not primarily of a law enforcement agency. Rather, from a company perspective, a complaint to the ombudsman would be a last-ditch effort at corruption prevention.

With the help of TI-USA, the idea was picked up and developed beyond one sector. The OECD agreed to act as a platform to promote the concept. The G20 countries and their B20 business representatives expressed their interest in this initiative at the summits of Cannes and Los Cabos in 2011 and 2012 (respectively). Colombia is the current pilot country, and has developed a concept in which complaints of solicitation trigger increased due diligence in specific procurement procedures.

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The current policy discourse on Collective Action

I mentioned that Collective Action has moved from being one of the most challenging problems in economics and the social sciences—an academic riddle—to being an eminently practical challenge for a diverse range of actors interested in combating corruption. For the private sector, Collective Action offers a way out of very concrete dilemmas. The private sector is most interested in Collective Action initiatives that are already underway and that could yet be created. The issue is no longer how to prevent free-riders. It is highly likely that non-compliant companies will be caught by law enforcement, especially if their competitors are ready to denounce them. The challenge is now to develop a reliable methodology for initiating and supporting Collective Action and to map and categorize the complex patchwork of current initiatives.

In G20 states, public and private sector policy groups (especially the B20) are currently promoting the creation of a network (“hub”) and web-based resources to collect and offer information about existing initiatives. So far, two such attempts to create a “hub” for Collective Action initiatives stand out.

First, the WBI’s 2008 guide for business on Collective Action contained a log of Collective Action case studies.

Second, together with actors from the private sector, the Basel Institute on Governance is establishing an International Center on Collective Action (ICCA). A network of organizations active on Collective Action and anti-corruption work, the ICCA is currently developing IT tools to provide business with information about Collective Action drawn from network members. The ICCA is already providing assistance in setting up concrete Collective Action initiatives and is using its experiences as the basis for further research.

Concluding remarks

The current interest in Collective Action as a means for combating corruption is a response to a drastic increase in regulatory risks for corporations. The topic has emancipated itself from the classic debates about “Collective Action problems”, “free-riders”, and “prisoners’ dilemmas”. It is a complex form of hybrid regulation (co-regulation) in which public and private sanctions together form a strong incentive to behave. The motivation for companies to participate in Collective Action on anti-corruption reflects their wish to escape from the trap of extortion, as well as their desire to earn recognition for their efforts to comply.

Promoting Collective Action is a crucial element in a wider strategy of combating corruption. It is about moving from talk to action. The private sector is taking its share of responsibility and control over the anti-corruption agenda. Civil society is there to foster, mediate, and monitor this development.

83 Reuben 2003, 1.
85 WBI 2008.
87 The ICCA has received seed funding from the Siemens Integrity Initiative.
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Neuwied, 492 et seq.

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